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CHARLES ELMORE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1930.

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

C. R. DEWEY,
Counsel for Petitioner.

(35,273)

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Supreme Court of the United States:

The petition of A. James Eckert respectfully shows:

1. On or about September 20th, 1929, the United States Board of Tax Appeals made and entered its decision and order determining a deficiency in the petitioner's income tax for the year 1925 in the amount of $3,378.89; appeal was duly taken by the United States Circuit Court of Appeals for the Second Circuit; on June 2nd, 1930, the Circuit Court of Appeals

affirmed the order of the United States Board of Tax Appeals; and a petition for rehearing was denied on June 26th, 1930.

2. The matters involved are as follows:

(*a*) The only issue in the case is whether the petitioner in computing his net income for income tax purposes is entitled to deduct from income as a bad debt, the sum of $22,400.00 representing indebtedness of the Electric Refrigeration Co., Inc., to the petitioner.

(*b*) The facts are undisputed. They may be summarized as follows:

Prior to 1922.—Petitioner and William Ainsworth were doing business as co-partners under the name of "Electric Refrigeration Company."

1922.—A corporation was organized under the name "Electric Refrigeration Co., Inc.," which took over all the assets and assumed all of the liabilities of the partnership among which were notes of $25,419.65.

1922-1925.—The corporation continued in business; it substituted its own notes for the old partnership notes and issued in addition, notes in the amount of $19,375.25. In 1925 prior to the dissolution, it had notes at the Citizens Trust Company of Utica, N. Y., for around $45,000.00. These notes were made by the corporation, but all of them were endorsed or guaranteed by the petitioner and Ainsworth.

1925.—The corporation was discontinued with no assets; the Bank called the notes above listed; the petitioner and Ainsworth went to the Bank in December, turned over all the cash that the Company had in the amount of some $600.00, which left a balance due on the notes of $44,800.00; gave their personal notes to the Bank in the amount of $44,800.00; and took up the notes of the corporation which were surrendered to them by the Bank and marked "Paid."

It was of course definitely ascertained in 1925 that the notes of the corporation which were taken up were absolutely worthless, the assets of the corporation being insufficient on dissolution in that year to pay any amount of the notes except for $600.00 and the notes being destroyed by the petitioner who regarded his one-half, $22,400.00, as a loss or bad debt for the year 1925.

(*c*) The petitioner claims a bad debt deduction based on his one-half of the notes of the corporation which he was obliged to take up as aforesaid—and not a business loss represented by the new personal notes given.

This is the vital distinction to be kept in mind, but a distinction both the Board and the Circuit Court of Appeals ignored.

The petitioner does not claim a business loss represented by the new personal notes—the petitioner claims a bad debt deduction for the corporation's notes which he acquired, ascertained to be worthless and charged off in 1925: a deduction authorized under Section 214

(*a*) of the Revenue Act of 1924 which provides that in computing net income there shall be allowed as deductions:

> "7. Debts ascertained to be worthless and charged off within the taxable year."

3. The reasons relied on for the allowance of the writ of certiorari hereinafter prayed for are as follows:

(*a*) While the amount involved in the case at bar is small, the principle and rule of law in question are of great importance both to the taxpayers generally and to the Government.

(*b*) There is a conflict between the decisions of the Circuit Courts of Appeals for the several Circuits. The holding in the case at bar is contrary to the decision of the Circuit Court of Appeals for the Seventh Circuit in the case of

> *S. R. Davis v. Commissioner*, 9 B. T. A., 755, reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928 (Vol. I, 1930, C. C. H. Tax Service, Par. 195.411).

In the case cited, the petitioner was the guarantor of certain notes given by the Multitone Manufacturing Co. This company went into the hands of a receiver in 1921. The petitioner then gave to the payee of the notes his own notes and received the notes upon which he was guarantor. He made a claim against the receiver of the corporation for the amount of the notes guaranteed by him and in 1921 received a final liquidat-

ing dividend from the Multitone Manufacturing Company. It was held by the Board that since the petitioner made his income tax return for 1921 on a cash receipts and disbursements basis, he was not entitled to deduct from the gross income of that year the amount of the notes given but not paid in that year. This holding was reversed by the Circuit Court of Appeals for the Seventh Circuit on October 24, 1928.

Therefore it will be seen from the above that the decisions of the several Circuits are not in harmony, since the holding by the Circuit Court of Appeals in the case at bar is the same as the holding of the Board in the S. R. Davis case—which holding was reversed by the Circuit Court of Appeals for the Seventh Circuit.

(*c*) The petitioner's position is a sound one.

While no extended discussion is proper here we believe that the position of the petitioner is a proper one for reasons which may be summarized as follows:

1. On payment to the Bank, the petitioner and Ainsworth became owners of the notes of the corporation which they had a right to enforce against the corporation.

2. The notes thus acquired were ascertained to be worthless in 1925, being charged off in that year.

3. The petitioner's share of the corporation's notes was therefore properly deductible as a bad debt for the year 1925, the absence of cash appearing in the transaction being immaterial.

WHEREFORE your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding said Court to certify and transmit to this Court, on a day to be therein designated, a full and complete transcript of the record and all proceedings of the said Court in this case, to the end that this case may be reviewed and determined by this Court as provided by law, and that the said judgment of the said Court in this case may be reversed by this Honorable Court and that your petitioner may have such other and further relief as to this Court may seem appropriate and in conformity with law.

C. R. DEWEY,
Counsel for Petitioner.

Office and P. O. Address: First National Bank Bldg., Utica, New York.

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AUG 14 1930
CHARLES ELMORE CROPLEY
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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1930.

No. 351

A. JAMES ECKERT, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

C. R. DEWEY,
Counsel for Petitioner.

(35,273)

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COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Statement of Grounds on Which Jurisdiction of Court is Based.

This is an application for writ of certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit made and entered June 2nd, 1930, affirming the order of the United States Board of Tax Appeals entered September 20th, 1929.

The decision of the United States Board of Tax Appeals is reported in Eckert *v.* Commissioner, 17 B. T.

A., 263; that of the Circuit Court of Appeals has not as yet been officially reported.

This application is made under Section 240 of the Judicial Code and accompanying and pertinent provisions.

Statement of Case.

The matters involved may be summarized as follows:

(*a*) The alleged deficiency in tax is income tax for the year 1925 in the amount of $3,378.89.

(*b*) The only issue in the case is whether the petitioner in computing his net income for income-tax purposes is entitled to deduct from income as a bad debt the sum of $22,400.00, representing indebtedness of the Electric Refrigeration Co., Inc., to the petitioner.

(*c*) The facts are undisputed. They may be summarized as follows:

Prior to 1922.—Petitioner and William Ainsworth were doing business as co-partners under the name of "Electric Refrigeration Company."

1922.—A corporation was organized under the name "Electric Refrigeration Co., Inc.," which took over all the assets and assumed all the liabilities of the partnership among which were notes of $25,419.65.

1922-1925.—The corporation continued in business; it substituted its own notes for the old partnership notes and issued in addition, notes in the amount of $19,375.25. In 1925 prior to the dissolution, it had notes at the Citizens Trust Company of Utica, N. Y.,

for around $45,000.00. These notes were made by the corporation, but all of them were endorsed or guaranteed by the petitioner and Ainsworth.

1925.—The corporation was discontinued with no assets; the Bank called the notes above listed; the petitioner and Ainsworth went to the Bank in December, turned over all the cash that the Company had in the amount of some $600.00, which left a balance due on the notes of $44,800.00; gave their personal notes to the Bank in the amount of $44,800.00; and took up the notes of the corporation which were surrendered to them by the Bank and marked "Paid."

It was of course definitely ascertained in 1925 that the notes of the corporation which were taken up were absolutely worthless, the assets of the corporation being insufficient on dissolution in that year to pay any amount on the notes except for $600.00 and the notes being destroyed by the petitioner who regarded his one-half, $22,400.00, as a loss or bad debt for the year 1925.

(*d*) The petitioner claims a bad-debt deduction based on his one-half of the notes of the corporation which he was obliged to take up as aforesaid and not a business loss represented by the new personal notes given.

This is the vital distinction to be kept in mind, but a distinction that both the Board and the Circuit Court of Appeals ignored. Both the Board and the Circuit Court of Appeals directed practically their entire consideration and discussion to the question whether the petitioner could deduct a loss represented by the per-

sonal notes which he gave—and as already stated, this is not the contention of the petitioner.

The petitioner does not claim a business loss represented by these new personal notes—the petitioner claims a bad-debt deduction for the corporation's notes which he acquired, ascertained to be worthless, and charged off in 1925.

The deduction is claimed under Section 214 (*a*) of the Revenue Act of 1924, which provided that in computing net income there shall be allowed as a deduction:

> "7. Debts ascertained to be worthless and charged off within the taxable year."

Outline of Argument.

In support of petitioner's application for a writ of certiorari, the petitioner respectfully advances the following points:

1. *While the amount involved in the case at bar is small, the principle and the rule of law in question are of great importance, both to the taxpayers generally and to the Government.*

2. *There is a conflict between the decisions of the Circuit Courts of Appeals for the several Circuits, which conflict should be settled by an adjudication of this court.*

3. *The position of the taxpayer is a sound one.*

ARGUMENT.

Point I.

While the amount involved in the case at bar is small, the principle and the rule of law in question are of great importance, both to the taxpayers generally and to the Government.

The situation involved in the case at bar is one which is constantly presenting itself.

Its importance to taxpayers generally and to the Government cannot therefore be over estimated.

Point II.

There is a conflict between the decisions of the Circuit Courts of Appeals for the Several Circuits, which conflict should be settled by an adjudication of this Court.

The Circuit Court of Appeals in the case at bar has by its decision refused to allow the petitioner to deduct as a bad debt his share of the notes of the corporation which he acquired in 1925 and ascertained to be worthless and charged off in that year, basing the decision largely on the ground that no cash passed at the time of the transaction.

This holding is directly contrary to the holding of the Circuit Court of Appeals for the Seventh Circuit in the case of

S. R. Davis v. Commissioner, 9 B. T. A., 755, reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928 (Vol. I, 1930, C. C. H. Tax Service, Par. 194.411).

In the case cited, the petitioner was the guarantor of certain notes given by the Multitone Manufacturing Co. This company went into the hands of a receiver in 1921. The petitioner then gave to the payee of the notes his own notes and received the notes upon which he was guarantor. He made a claim against the receiver of the corporation for the amount of the notes guaranteed by him and in 1921 received a final liquidating dividend from the Multitone Manufacturing Company. It was held by the Board that since the petitioner made his income-tax return for 1921 on a cash receipts and disbursements basis, he was not entitled to deduct from the gross income of that year the amount of the notes given but not paid in that year. This holding was reversed by the Circuit Court of Appeals for the Seventh Circuit on October 24, 1928.

Therefore it will be seen from the above that the decisions of the several Circuits are not in harmony, since the holding by the Circuit Court of Appeals in the case at bar is the same as the holding of the Board in the S. R. Davis case—which holding was reversed by the Circuit Court of Appeals for the Seventh Circuit.

Point III.

The position of the taxpayer is a sound one.

The petitioner realizes that the primary purpose of this brief, accompanying the petition for a writ of certiorari, is to satisfy this Court that there

is an issue involved in this case which should be passed on by this Court to settle the conflict in authorities that now exists in the lower courts.

Therefore your petitioner realizes that any detailed argument substantiating the correctness of the petitioner's position would be out of place.

It may not, however, be amiss to outline the following reasons on which is based the petitioner's position.

1. *On payment to the bank the petitioner and Ainsworth became the owners of the notes of the corporation which they had a right to enforce against the corporation.*

This point needs no citation of authority, for automatically one who takes up notes on which he is an endorser becomes the owner of the notes and has a right to enforce them against the corporation.

Knowing these notes to be worthless in 1925, each naturally wrote off his one-half as a bad debt—a thing which he would naturally assume he had a perfect right to do.

2. *The notes thus acquired were ascertained to be worthless in 1925 being charged off in that year.*

This point has not been disputed.

3. *The petitioner's share of the corporation's notes was therefore properly deductible as a bad debt for the year 1925, the absence of cash appearing in the transaction being immaterial.*

Section 214 (*a*) of the Revenue Act of 1924 provides that in computing net income there shall be allowed as deductions:

> (4) Loss sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (7) Debts ascertained to be worthless and charged off within the taxable year * * *

We believe that the deductibility of the amount in dispute would be conceded if cash had actually passed when the corporation's notes were taken up.

We think that this objection rests upon a misapprehension of the petitioner's position, and that in the present case the absence of cash does not prevent deductibility for the following reasons:

(*a*) *We are here claiming a bad debt deduction on the notes of the corporation acquired as aforesaid—not a business loss represented by the new personal notes given.*

This is the vital distinction to be kept in mind.

We do not claim a business loss represented by the new personal notes; we claim a deduction for the corporation's notes, ascertained to be worthless in 1925.

(*b*) *In such a case, the presence of cash is not required by the authorities.*

The Board and the Circuit Court of Appeals have, we believe, confused this case with the ordinary case

where a taxpayer on a cash basis attempts to claim a loss for notes given by him but not yet paid.

These cases are numerous and sound, but have no application here, where the deduction is based on the notes acquired.

Under the authorities, the taxpayer is entitled to deduct his share of the worthless notes in 1925.

To the best of our knowledge there are only three cases in which this question is considered, and all of them are decisive of the question in our favor.

S. R. Davis v. Commissioner, 9 B. T. A., 755, reversed by the Circuit Court of Appeals for the Seventh Circuit October 24, 1928 (Vol. I, 1930, C. C. H., Tax Service, Par. 195.411).

The case cited has already been discussed under Point II. Its holding is directly contrary to that of the Court in the case at bar, and directly in accord with the petitioner's position.

The second case in which the point here involved is considered is

A. W. D. Weis v. Commissioner, 13 B. T. A., 1284.

In the case cited, the petitioner and one Morgan conducted a lumber company which gave to the bank its notes. In 1919 the bank called the notes and the petitioner gave his personal note for the amount of the principal and interest due on the company's note which he took up. The business was wound up in 1919 and it was then ascertained that the company would have little or no assets to apply on its note. The personal note given by the petitioner was not

paid until 1923. Nevertheless the petitioner was allowed to deduct in the year 1919 the amount of the principal and interest due on the corporate notes which he had taken up.

The third case in which the point here at issue has been considered is that of

Maurice Sass v. Commissioner, 7 B. T. A., 557; modified in 12 B. T. A., 156; affd. in 17 B. T. A., 261.

Here the petitioner claimed as a deduction the amount due on notes guaranteed by the petitioner which he had been obliged to take up and for which he had substituted his own notes not paid in the taxable year. The final holding of the Board was that the deduction could not be taken because it was not shown that the notes taken up were worthless in the year in which taken up. The Board said in part, in 17 B. T. A., at 263:

> "* * * petitioner has not shown that he is entitled to a deduction of $19,253.54 by reason of the fact that he gave his note in that amount to the bank in the year 1919. Even under the petitioner's claim, in order to become entitled to a deduction of this amount, it is incumbent upon him to show by a preponderance of the evidence that the obligations of the borrowers, whose notes he had guaranteed, were worthless in the year 1919 and this he has failed to do. The mere fact that the bank called upon petitioner to take care of the unpaid notes of others, the payment of which he had guaranteed, and that he gave to the bank his promissory note, does not of itself prove that he has sustained a

deductible loss in the year in which he gave his note. When petitioner gave his note to the bank he was subrogated to all rights of the bank against the makers of the notes remaining unpaid at that time and there is not sufficient evidence in this record to convince the Board that the notes given to the bank and taken over by petitioner were worthless and uncollectible in the taxable year. This fact distinguishes this case from the proceeding of S. R. Davis, 9 B. T. A., 755, and A. W. D. Weis, 13 B. T. A., 1284."

But in the case at bar there is proof—and in fact no contention to the contrary—that the notes of the corporation which the petitioner took up were worthless and were ascertained to be worthless in the year 1925; the Board finding that "subsequently in 1925 the corporation discontinued business and proceeded to wind up its affairs, its assets on dissolution being insufficient to pay the amount due on the notes in excess of about $600.00;" and the petitioner and Ainsworth being obliged to take care of the rest by giving their notes for the deficiency of $44,800.00.

We shall not, however, pursue this angle further, since if the Commissioner's sole requirement is the presence of tangible consideration passing from the taxpayer, this requirement can readily be met.

(c) *As to $25,000.00 of the notes, the petitioner has actually paid out tangible consideration.*

The petitioner and Ainsworth in 1922 had partnership property and partnership liabilities, among them notes in the amount of $25,000.00.

They parted with the property in 1922 in return for the assumption of the liabilities.

In other words, the partners conveyed their property in return for the corporation's promise to pay the liabilities and hold the partners indemnified.

This obligation of the corporation was represented, at least up to $25,000.00, by the notes on which the corporation was primarily liable as maker and the individuals secondarily liable as indorsers; and with respect to which the corporation was bound to hold the indorsers harmless, not merely by the express agreement of 1922, but also by the implied obligation imposed by law.

This obligation, represented by these notes, became worthless in 1925.

The petitioner had transferred his property in 1922 for this obligation. He had paid for it in tangible consideration in 1922. If it becomes worthless in 1925, why cannot he deduct it?

The suggestion was made that when the individuals in 1925 gave their notes they were remitted to their 1922 position. That is not so—their liabilities have returned, but their properties have not.

(d) As to the remaining $19,000.00 of notes issued after 1922, to insist on the presence of cash in their payment in 1925 would be to insist on an idle form.

While we believe that the presence of tangible consideration in respect to $25,000.00 of the notes will meet the objection of the Board as to that portion of

the notes, we admit that as to the remaining $19,000.00 no cash or property passed.

For reasons already advanced, we do not believe that the presence of cash or tangible consideration is important.

If, however, it be insisted on as to the remaining $19,000.00 of notes, we have an insistence on an idle form.

The situation, effect and result of the transaction is exactly the same as if the petitioner and Ainsworth in 1925 had gone to the Bank, given their notes, deposited the proceeds in their accounts, checked it out to the Bank, and taken up the notes.

It would seem unnecessary to insist on a mere matter of useless form; the result would seem to be the proper test.

And, as already said, the result was exactly the same as if cash had passed.

4. *The fact that the notes were worthless when acquired is immaterial.*

The entire opinion of the Circuit Court, with the single exception of the last sentence, and the entire citation of authorities, was directed to the same question which occupied the Board's attention—whether petitioner could deduct a loss represented by the personal notes which he gave—and that proposition is not in issue.

The only reference to petitioner's real claim, that he is entitled to a deduction as a bad debt of his share

of the worthless notes of the corporation, is the last sentence in the opinion, stating:

> "Nor is the taxpayer entitled to a deduction under clause 7 as a debt ascertained to be worthless and charged off during the year, because the debt was worthless when the taxpayer acquired it."

No authority is cited for this statement; and the authorities hereinabove referred to show that in such a case as this, where a taxpayer is compelled to take up paper, its worthlessness at the time does not prevent its charge-off and deductibility for income tax purposes.

Conclusion.

In view of the importance of the question involved and of the conflict now existing between the decisions in the Circuit Courts of Appeal, petitioner respectfully prays that a writ of certiorari may issue out of this Court as prayed for in the accompanying petition.

Respectfully submitted,

C. R. DEWEY,
Counsel for Petitioner.

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